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IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. A–601

ASSOCIATED GAS DISTRIBUTORS,

Petitioner,

v.

FEDERAL POWER COMMISSION,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioner, Associated Gas Distributors (AGD), respectfully prays that a writ of certiorari be issued to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit entered in this case on October 14, 1975.

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OPINION BELOW

The opinion of the Court of Appeals has been reported at 520 F.2d 1061. It appears as Appendix A in the Joint Appendix (1061).

JURISDICTION

The judgment of the Court of Appeals was entered on October 14, 1975. This Court's jurisdiction is invoked under 28 U.S.C. §1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. §717r(b).

QUESTION PRESENTED

Whether the Federal Power Commission (FPC or Commission) may permit gas sold by producers selling gas in the interstate market under "renewal contracts"[1] to be regulated at the rate ceiling designed as an incentive rate for new gas exploration and development in the absence of any assurance that the resulting increase in revenues will promote any incremental gas exploration or development

STATUTORY PROVISIONS INVOLVED

The relevant provisions of the Natural Gas Act, 15 U.S.C. §717 *et seq.*, are set forth in Appendix E of the Joint Appendix.

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[1]The term "renewal contracts" is defined in the Statement of the Case, *infra*, pp. 4-5.

STATEMENT OF THE CASE

This case arises out of a determination by the Federal Power Commission that the price ceiling for *new* gas should be applied to *flowing gas* deliveries upon the expiration of old contracts and the filing of new contracts covering the same service and the same gas.

AGD is an unincorporated association of natural gas distribution companies,[2] providing gas utility service to consumers in many of the major market centers in the eastern portion of the United States. Individually, AGD companies bear the legal responsibility of maintaining adequate natural gas utility service and supplying the needs of their customers at reasonable rates within their respective franchise areas. As a result of the FPC decision here under review, regulated gas producers are now collecting substantially increased charges for gas sold to interstate pipelines. In response to these producer increases, those pipelines furnishing service to the AGD companies have placed in effect major increases in their rates for wholesale deliveries. Accordingly, AGD's interest here is that of protecting its consumers from any unnecessary or unlawful increases in the cost of natural gas.

A. Proceedings Before the FPC

The proceeding below was a consolidated proceeding to review various opinions and orders promulgated by the Commission in FPC Docket No. R-389-B, denominated "Just and Reasonable National Rates for Sales of Natural Gas from Wells Commenced On or After January 1, 1973, and New Dedications of Natural Gas to Interstate Commerce On or After January 1, 1973."

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[2]The names of the AGD member companies are listed on the inside front cover of this brief.

This proceeding was begun on April 11, 1973, when the Commission issued its Notice of Proposed Rulemaking and Order Prescribing Procedures.[3] This Notice was supplemented on March 21, 1974, by a "Notice of Issuance of Revised Staff Nationwide Cost Study and Staff Study of American Gas Association Reserve Editions."[4] Each of these Notices was followed by the filing of extensive initial and reply comments of interested parties, including AGD.

The Commission issued Opinion No. 699 (R. 2632) on June 21, 1974; that Opinion established a new, uniform national base rate of $.42 per Mcf applicable to the following categories of interstate sales of natural gas:

1. Sales from new wells commenced on or after January 1, 1973;

2. Sales made under contracts executed on or after January 1, 1973, for gas which had not previously been sold in interstate commerce, except under short-term and emergency sale procedures of the Commission's regulations; and

3. Sales made pursuant to contracts executed on or after January 1, 1973, where the sales were formerly made pursuant to permanent certificates of unlimited duration under contracts which expired by their own terms on or after January 1, 1973. These contracts are hereinafter referred to as "renewal contracts."

AGD, on July 22, 1974, filed an Application for Rehearing of Opinion No. 699, alleging, *inter alia*, that the Commission should circumscribe its application of the new gas price to *newly dedicated gas reserves* and that such price should *not* apply to renewal contracts, i.e., to those sales covered by category 3 above.

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[3] 28 Fed. Reg. 10014 (1973).

[4] 39 Fed. Reg. 11310 (1974).

In Opinion No. 699-A, issued August 2, 1974, the FPC expanded the scope of this third category to include *all* renewal contracts executed on or after January 1, 1973, regardless of the expiration date of the original contract.

On December 4, 1974, the Commission issued Opinion No. 699-H (R. 3521). This Opinion (a) denied AGD's rehearing application and reaffirmed the Commission's earlier rulings insofar as the application of the new gas price ceiling to renewal contracts was concerned, and (b) increased the rate ceiling applicable to all categories of "new gas" contracts from $0.42 to $0.50 per Mcf.

Opinion No. 699-H also provided that gas sold from reservoirs discovered on or after January 1, 1973, as a result of a well commenced on or after January 1, 1973, would be entitled to the new gas ceiling rate, notwithstanding the fact that the gas was sold from acreage previously dedicated to interstate commerce under a contract dated prior to January 1, 1973.[5]

B. The Opinion Below

AGD filed its Petition for Review of Opinion Nos. 699 and 699-H in the United States Court of Appeals for the District of Columbia Circuit. This Petition was transferred to the United States Court of Appeals for the Fifth Circuit by order of the District of Columbia Circuit issued on March 6, 1975, after the February 20, 1975 order of the Fifth Circuit, asserting jurisdiction over all Petitions for Review of opinions and orders in Docket No. R-389-B.

The opinion below was issued by the Fifth Circuit on October 14, 1975.[6] The court below followed a "limited

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[5] 18 C.F.R. Sec. 2.56a(k).

[6] *Shell Oil Company v. FPC*, 520 F.2d 1061 (5th Circuit 1975) (R. 1061).

review" approach to this case, noting that many of the essential elements of this rate order were supported "with little more than *ipse dixit*."[7] It noted with "regret" that "the FPC continues to issue orders which would be inadequate but for our 'kid glove' treatment."[8] In upholding the Commission's application of the new gas rate ceiling to renewal contracts, the Fifth Circuit relied primarily on the Commission's finding that additional "internally generated sums" are necessary to support a massive commitment of new funds to the gas exploration effort.[9]

REASONS FOR GRANTING THE WRIT

1. THE DECISION BELOW DEPARTS RADICALLY FROM THE REVIEW STANDARDS PREVIOUSLY APPLIED BY THIS COURT TO FEDERAL POWER COMMISSION RATE ORDERS.

a. The Decision Below Ignores The Requirement of "Reasoned Consideration of the Public Interest".

In *Permian Basin Area Rate Cases (Continental Oil Co. v. FPC)*,[10] this Court delineated standards for judicial review of producer rate orders of the Federal Power Commission. Such orders must neither abuse nor go beyond the Commission's authority, and each of the orders' critical elements must be supported by substantial evidence. Every aspect of the orders germane to the protection of public, as well as private, interests, both existing and foreseeable, must be afforded "reasoned consideration." This Court has stressed the fact

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[7] *Ibid.* at 1072.

[8] *Ibid.*

[9] *Ibid.* at 1077.

[10] 390 U.S. 747, 791-792, 88 S.Ct. 1344, 1372-1373, 20 L.Ed.2d 312, 350 (1968).

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that the application of these criteria of judicial review is principally the duty of the courts of appeals.[11]

The Natural Gas Act evidences a Congressional mandate to hold prices for gas "at the lowest possible reasonable rate consistent with the maintenance of adequate service in the public interest."[12] Additional supplies of gas, as well as reasonable rates for such gas, are part of the public interest considerations involved. The Commission may consider "the 'probable consequences' of a given price level for future programs of exploration and production"[13] because its duties entail the protection of both future and current consumer interests.[14]

FPC Opinion No. 699-H, affirmed below, reflects a major departure from the pattern of producer rate regulation first upheld in *Permian* and consistently applied until this case. In *Permian* and subsequent area rate cases, the Commission established a "two price system" for producer rate regulation. Under that system, the Commission prescribed a higher ceiling rate for new and recent gas sales; such rate was designed to serve as an incentive for the commitment of gas supplies to interstate commerce. A lower ceiling rate, based on average historical costs, was applied to gas sold under older "flowing gas" contracts, "since price could not serve as an incentive"[15]

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[11] *Mobil Oil Corp. v. FPC*, 417 U.S. 283, 309-310, 94 S.Ct. 2328, 2346, 41 L.Ed.2d 72, 95-96 (1974). *See* also *Permian Basin Area Rate Cases, supra*, 390 U.S. at 766, 88 S.Ct. at 1359, 20 L.Ed.2d at 335-336.

[12] *Atlantic Ref. Co. v. Public Service Commission*, 360 U.S. 378, 388, 79 S.Ct. 1246, 1253, 3 L.Ed.2d 1312, 1319 (1959), which quotes original §7(c) of the Natural Gas Act, 52 Stat. 825 (1938). Although that section of the Act was later excised, it remains a primary purpose of the Act. 360 U.S. at 388 n. 7, 79 S.Ct. at 1253 n. 7, 3 L.Ed.2d at 1319 n. 7.

[13] *Permian, supra*, 390 U.S. at 797, 88 S.Ct. at 1375-1376, 20 L.Ed.2d at 353.

[14] *Ibid.* at 798, 88 S.Ct. at 1376, 20 L.Ed.2d at 353-354.

[15] *Ibid.* at 797.

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for such sales. In the subject order, however, the Commission destroyed much of the distinction between "flowing gas" and "new gas." By holding that gas sold under renewal contracts is entitled to the new gas ceiling rate, the Commission reclassified a substantial volume of interstate gas supply from the flowing gas category to the status of new gas. The effect of this reclassification is to increase substantially (by more than 100 percent) the price of the already available interstate gas supply with *no* corresponding benefits to the consumer.

Despite the significant consumer impact of this "repricing" of renewal contracts, the court below failed to apply the judicial review standards set forth in *Permian* and recited above. Thus, the Fifth Circuit expressed its "regret" that the FPC "continues to issue orders which would be inadequate but for our 'kid glove' treatment."[16] It recognized the Commission's "failure to assess the consequences of its various policies" and that many of the essential elements of its order were supported "with little more than *ipse dixit.*"[17]

A review of the opinion below indicates that this extraordinary deferential, "hands off" approach was applied to the renewal contract issue. Thus, the court explained its ruling on this issue by citing the Commission's finding

> "that a massive commitment of new funds is necessary to alleviate the natural gas shortage and that internally generated funds are a necessary source of such funds. Additionally, it noted that by phasing out the vintaging practice and attending price variations, all consumers would more equitably bear the burden of financing added exploration."[18]

The mere repetition of these Commission findings falls well short of the judicial review standards established by this

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[16] *Shell, supra,* at 1072.

[17] *Ibid.*

[18] *Ibid.* at 1077.

Court. Had the court below applied "reasoned consideration" to the public interest aspects of the renewal contract policy, it could not have affirmed the Commission. There is no logical or reasonable relationship between the need for massive new funds to finance additional gas exploration and the treatment of renewal contracts as "new gas" sales. The revenues gained from rate increases on renewal contracts may be invested in *any* area of business activity open to the producing industry. The rational, logical assumption here is that the producing industry, comprised primarily of *oil* companies, would devote these increased revenues to the non-regulated sector of their operations–be that oil, intrastate gas exploration, uranium or real estate.

The lack of any nexus between renewal contract revenues and added exploration for the benefit of the regulated interstate market is an obvious fact, given the nature of the producing industry and present economic circumstances. To assume that the Fifth Circuit did not appreciate or understand this fact would be to impute extreme naivete to it.

The court below also noted that the Commission pinioned its "application of the new, higher rate to 'old' gas as primary contracts expire" on the *belief* that such a methodology would "generate added funds for greater exploration."[19] The court recognized the precatory nature of the Commission's reasoning when it stated:

> "*The FPC* thus applied the rate functionally to 'old' gas rather than on a cost-related basis, *hoping that a higher uniform rate will help alleviate the current severe shortage.* The FPC *believed* that by requiring an old contract to be renegotiated before the new rate is recoverable, the pipeline *might* be able to negotiate for additional acreage dedication to interstate commerce, or exploration and development activity on previously dedicated

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[19] *Shell, supra,* at 1077.

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> acreage or other concessions for the price increase."[20] (Emphasis supplied.)

On this basis, the court concluded that the "FPC has reached a well-considered, expert decision on this issue."[21] The court's conclusion in favor of the Commission's "belief" repudiates the reality of producer-pipeline negotiations, especially in view of the critical, nationwide gas supply shortage. The notion that pipelines would be able to exact *quid pro quo* concessions from producers under the present, adverse bargaining conditions is totally illusory. This Court, as well as others, has acknowledged the superior bargaining power of the producers,[22] and Congress recognized it full well when it required the Commission to regulate prices.

It follows that the Fifth Circuit's ruling, like that of the Commission, was "little more than *ipse dixit.*" Surely it does not approach the "reasoned consideration of the public interest" which this Court has established as the criterion for judicial review. Therefore, the decision below poses the basic question of whether major nationwide gas rate orders issued by the FPC are to be accorded extraordinary "kid gloves" deference by reviewing courts.

b. No Substantial Evidence Was Presented To The Effect That The Commission's Regulation Of Renewal Contracts Would Enhance The Development Of Gas Supplies For The Interstate Market.

As indicated above, the Commission's basic rationale for its renewal contract policy was its desire to provide funds for additional gas exploration and development efforts. However appropriate this goal, the instant order provides *no* evidence

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[20] *Ibid.*

[21] *Ibid.*

[22] *FPC v. Texaco, Inc.*, 417 U.S. 380, 397, 94 S.Ct. 2315, 2326, 41 L.Ed.2d 141. *See* also *Macdonald v. FPC*, 164 U.S.App.D.C. 248, 256, 505 F.2d 355, 363 (1974); *United Gas Improvement Co. v. FPC*, 290 F.2d 133, 135, *cert. denied*, 368 U.S. 823, 82 S.Ct. 41, 7 L.Ed.2d 27 (1961).

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that the additional revenue generated by repricing renewal contracts will be utilized to augment gas exploration and development efforts. The court below, at 520 F.2d 1071, moreover, repudiated the requirement that the Commission findings be supported by substantial evidence.

> "Opinions 699 and 699-H assert many factual conclusions and regulatory justifications without explicating for this Court the factual predicates or assumptions upon which such decisions are based."

Furthermore, the Fifth Circuit overlooked its own prior admonishment to the Commission that in future rate orders it must continue to produce substantial evidence to support any change in the vintaging elements of the rate structure,[23] and that it "must explain the relationship between the level of service, the demand for service and the price it sets;"[24] the Commission

> *"must then make findings, as specifically as possible, as to how the rate it has set will affect the industry's tendency to meet the level of service (needed by consumers). This last step means estimating the gas supply that the rate will bring forth."*[25]

The rationale given by the Fifth Circuit for relaxing its review standards does not square with the Natural Gas Act. The court explained that the instant order "requires continuation of the heightened deference to the Commission's expertise inherent in the 'experiment doctrine.' "[26] But the "experiment doctrine" does not remove the substantial

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[23] *Shell Oil Company v. FPC*, 491 F.2d 82, 89-90 (5th Cir. 1974).

[24] *Austral Oil Company, et al. v. FPC*, 428 F.2d 407, 444 (1970), on rehearing, 444 F.2d 125 (1970); *cert. denied sub nom. Municipal Group v. FPC*, 400 U.S. 950 (1970).

[25] *Ibid.* (Emphasis supplied.)

[26] *Shell, supra*, 520 F.2d at 1071.

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evidence test as an essential court standard. That standard is set forth in the Natural Gas Act[27] and has been consistently applied by this Court.[28]

2. THE MAGNITUDE OF THE BONUS GUARANTEED PRODUCERS UNDER THE COMMISSION'S ORDERS AND OPINIONS HEREIN AND THE CONCOMITANT ECONOMIC BURDEN THRUST UPON THE CONSUMER WARRANT THE ISSUANCE OF A WRIT OF CERTIORARI BY THIS COURT.

Viewed in the context of the Commission's overall program of producer rate regulation, the economic consequences of the instant order are a major consideration. *The dollar impact on the nation's gas consumers* of the FPC's renewal contract policy is truly enormous.

The original conception of the pricing policy embodied in the subject order occurred in FPC Opinion No. 639,[29] promulgated on December 12, 1972. The effect of that order was to permit renewal contracts to be priced at the then-prevailing *area* ceiling rates for new gas. Depending on the pricing area involved, this 1972 decision resulted in unit escalations in the 5 to 10-cent range, or from 30-50 percent over the base rate previously applied to the same gas supply.[30] The record contains no estimate of the total dollar impact of this feature of Opinion No. 639.

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[27] "The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive." 15 U.S.C. Sec. 717r(b).

[28] *See Mobil Oil Corp. v. FPC, supra,* and *Permian Basin Area Rate Cases, supra.*

[29] *Area Rates for Appalachian and Illinois Basin Areas,* 48 F.P.C. 1299 (1972), *rehearing denied,* 49 F.P.C. 361 (1973), *aff'd sub nom. Shell Oil Co. v. FPC,* 491 F.2d 82 (5th Cir. 1974).

[30] In the Texas Gulf Coast area, for example, the rate increase effect of Opinion No. 639 was to enable sellers with renewal contracts to collect 25 cents per Mcf, an increase of 6 cents over the flowing gas rate previously applicable to the same gas supply.

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The direct dollar impact of the present order, although not subject to precise measurement, is estimated at $2.6 billion over the six-year period from 1974 through 1981.[31] This is the cumulative impact resulting from the sizeable number of rate filings under which gas already dedicated and flowing in the interstate market will be sold at the 50-52-cent level as compared with the flowing gas rate previously allowed. To place the $2.6 billion figure in perspective, this sum would be sufficient to find, develop and produce 5 trillion cubic feet of new natural gas—more than one-third the total volume sold in interstate commerce during 1974.[32]

Looking to the future, additional escalations in the new gas rate ceiling may be prescribed by the Commission. In Docket No. RM75-14, the Commission proposes to adjust the nationwide ceiling for new gas sales commenced during the 1975-76 biennium.[33] The FPC Staff has there recommended the new gas rate be increased to a level in the range of 75 cents to $1.00. Other parties, including AGD, have also recommended an upward revision of the new gas ceiling rate. The outcome of this pending proceeding necessarily remains uncertain. Nonetheless, it is possible, if not entirely foreseeable, that a further significant increase in the new gas price will be approved. If any such higher price is approved *and applied to renewal contracts*, the $2.6 billion impact figure would be subject to upward revision.

Given the nationwide scope of the Commission's rate orders, large financial consequences are to be anticipated. But

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[31] *See* Opinion No. 699-H, Commissioner Smith's decision concurring in part and dissenting in part (R. 3628).

[32] According to Opinion No. 699-H, the current cost of new gas is 50 cents per Mcf. Dividing the latter figure into $2.6 billion yields approximately 5 trillion cubic feet.

[33] *See* "National Rates for Jurisdictional Sales of Natural Gas Dedicated to Interstate Commerce On or After January 1, 1973, for the Period January 1, 1975, to December 31, 1976," FPC Notice issued December 4, 1974.

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here a single, almost-tangential feature of the Commission's order has a multi-billion dollar consumer impact which could well be escalated in the near future. In light of the Commission's primary obligation to the nation's gas consumer, and the imminent possibility of further escalations in dollar impact, the financial consequences of the subject orders are alone a weighty factor in support of the grant of this petition.

CONCLUSION

For these reasons, a writ of certiorari should be issued to review the judgment and opinion of the Fifth Circuit.

Respectfully submitted,

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